



Moody's Investors Service

Global Credit Research

New Issue

9 JUL 2001

New Issue: Honolulu (City & County of) HI

MOODY'S ASSIGNS Aa3 RATING TO HONOLULU'S WASTEWATER SYSTEM REVENUE BONDS

\$192 Million of Debt Affected

Water/Sewer
HI

Moody's Rating

ISSUE

Wastewater System Revenue Bonds, Senior Series 2001

Sale Amount \$140,000,000

Expected Sale Date 07/10/01

Rating Description Wastewater System Revenue Bonds, Senior Series 2001

RATING

Aa3

Opinion

NEW YORK, Jul 9, 2001 -- Moody's has assigned an Aa3 rating to the City and County of Honolulu's Wastewater System, Senior Series 2001 and has affirmed the A1 rating on the system's junior lien revenue bonds. The ratings are based on favorable coverage of debt service requirements provided by existing revenues, the projection of aggressive, but manageable rate increases to meet targeted coverage levels, and the favorable economic base served by the wastewater enterprise. Also noted in the rating assignments are the system's capital plans which will require significant additional borrowings. The stable rating outlook is based on Moody's expectation that, despite the presence of significant future borrowing plans, the wastewater system will maintain the conservative financial and debt policies stipulated by city council resolution.

EXISTING SYSTEM REVENUES PROVIDE FAVORABLE DEBT SERVICE COVERAGE

The wastewater system's revenue bonds are secured by a pledge of net system revenues. Existing system revenues provide favorable coverage of revenue bond debt service requirements with net pledged revenues for fiscal years 1999 and 2000 providing 3.9 and 4.8 times coverage of peak debt service on the senior lien bonds, respectively. Coverage of the combined maximum debt service requirements for the senior lien and junior lien bonds equaled 1.6 times for 2000. The long-term projections provided by management illustrate that coverage levels will comply with the system's adopted policy at a satisfactory 1.6 times on senior lien bonds and 1.25 times on combined senior and junior lien bonds over the next ten years.

The system provides wastewater services for approximately 70% of the island of Oahu's population. The customer base is diversified with residential users representing more than 77% of the system's revenues while the ten largest customers account for less than 3% of the flow. The system operates eight wastewater treatment plants serving an area of approximately 500 square miles. The system currently provides secondary treatment for approximately 30% of the waste-water flow while the remainder is treated only to the primary level in accordance with EPA waivers, resulting in regulatory compliance issues as discussed below.

While sewer service rates are relatively high, at approximately \$400 annually for typical residential customers, it is noteworthy that combined water and sewer rates are more comparable to the bills of urban systems on the mainland. Future rate increases appear aggressive though manageable at 11% in 2003, peaking at 13% in each of 2004 and 2005, then declining from 11% in 2006 to 6.5% in 2010. Moody's notes, however, that these increases are nearly twice the magnitude of estimates presented in 1998, due primarily to overall growth in the capital improvement plan and acceleration of certain large projects. Moody's believes

that a key rating factor going forward will be the city's ability to implement regular rate increases sufficient to maintain projected coverage levels, without significant delay in implementation or substantive changes in the magnitude of the planned increases.

SUBSTANTIAL CAPITAL IMPROVEMENT PLANS TO ADDRESS REGULATORY CONCERNS

Since 1991, the Environmental Protection Agency, the State of Hawaii, and several environmental groups have filed various legal and regulatory actions against the City and County of Honolulu alleging violations of the federal Clean Water Act and several of the permits held by the wastewater department. Honolulu has entered into four consent decrees, in connection with the settlement of these actions, which establish a required compliance schedule for project implementation. The consent decrees require Honolulu, among other things, to rehabilitate and expand certain existing facilities and to construct new facilities. In addition to actions taken to date, the wastewater department has developed capital improvement plans covering

periods of five, ten and twenty years, in part, to comply with the existing consent decrees. The system's capital improvement plan identifies approximately \$1.6 billion in projects through 2010 and roughly \$2.4 billion through 2017. Beyond addressing the consent decrees, the long-range capital program will also address safety and public health, permit compliance, system expansion and reliability issues. Capital expenditures over the next five-year period are estimated to total \$766 million, the majority of which is expected to be funded from the proceeds of additional senior lien bonds.

As with other wastewater treatment systems, the City and County of Honolulu faces evolving state and federal regulations on treatment and discharge standards. The potential for stricter standards in the future adds a measure of uncertainty to the system's future capital needs and additional borrowing plans beyond those currently contemplated by management. However, Moody's believes that the phased aspects of the system's twenty-year capital improvement program will provide management with a fair degree of flexibility to address potential future changes in regulatory requirements.

FAIRLY STANDARD LEGAL PROVISIONS BOLSTERED BY ADOPTION OF FORMAL FINANCIAL POLICIES BY GOVERNING BOARD

Legal provisions include covenants to maintain a Debt Service Reserve Fund, equal to maximum annual debt service requirements, on both liens of bonds and stipulate the maintenance of rates and charges sufficient to generate net revenues at least equal to 1.20 times the amount needed to pay debt service on the senior lien bonds and 1.10 times on combined senior and junior lien debt service. A similar covenant is provided for the issuance of additional parity bonds under both liens although officials report that most future borrowing is expected to be issued through the senior lien. The reimbursable general obligation bonds, as well as the debt service on the system's state revolving fund loans, are secured by a lien on net system revenues which is subordinate to the lien created by the junior lien bonds.

Legal provisions are significantly bolstered by the formal adoption of conservative debt and financial operating policies by the city council which require compliance with annual targets of 1.6 times coverage on the senior lien bonds and 1.25 times on all bonds. In addition, the city council resolution incorporates a favorable three month operating and maintenance reserve fund policy which will serve to insulate the system from unexpected events. Moody's expects that the system will comply with these more stringent operating policies as opposed to the levels stipulated by the legal covenants of the bond documents.

Outlook

The stable rating outlook is based on Moody's expectation that, despite the presence of significant future borrowing plans, the wastewater system will maintain the conservative financial and debt policies stipulated by city council resolution. Furthermore, Moody's expects that future debt issuance will be managed prudently to ensure the continuation of debt measures which are comparable with other highly-rated enterprise systems.

KEY STATISTICS

Service area population, 2000: 876,156

Operating ratio, 2000: 51.1%

Senior lien debt service coverage, 2000: 22.9x

Combined senior and junior lien debt service coverage, 2000: 4.2x

Peak senior lien debt service coverage by FY 2000 net revenues: 4.8x

Debt ratio, 2000: 44.1%

Analysts

Matthew Jones
Analyst
Public Finance Group
Moody's Investors Service

Kenneth Kurtz
Director
Public Finance Group
Moody's Investors Service

Contacts

Journalists: (212) 553-0376
Research Clients: (212) 553-1625

© Copyright 2002 by Moody's Investors Service, 99 Church Street, New York, NY 10007. All rights reserved.

ALL INFORMATION CONTAINED HEREIN IS COPYRIGHTED IN THE NAME OF MOODY'S INVESTORS SERVICE, INC. ("MOODY'S"), AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT. All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human and mechanical error as well as other factors, however, such information is provided "as is" without warranty of any kind and MOODY'S, in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability or fitness for any particular purpose of any such information. Under no circumstance shall MOODY'S have any liability to any person or entity for (a) any loss or damage in whole or in part caused by, resulting from, or relating to any error (negligent or otherwise) or other circumstance or contingency within or outside the control of MOODY'S or any of its directors, officers, employees or agents in connection with the procurement, collection, compilation, interpretation, communication, publication or delivery of any such information, or (b) any direct, indirect, special, consequential, compensatory or incidental damages whatsoever (including without limitation, lost profits), even if MOODY'S is advised in advance of the possibility of such damages, resulting from the use of, or inability to use, any such information. The credit ratings, if any, constituting part of the information contained herein are, and must be construed solely as, statements of opinion and not statements of fact or recommendations to purchase, sell or hold any securities. NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER. Each rating or other opinion must be weighed solely as one factor in any investment decision made by or on behalf of any user of the information contained herein, and each such user must accordingly make its own study and evaluation of each security and of each issuer and guarantor of, and each provider of credit support for, each security that it may consider purchasing, holding or selling. Pursuant to Section 17(b) of the Securities Act of 1933, MOODY'S hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MOODY'S have, prior to assignment of any rating, agreed to pay MOODY'S for the appraisal and rating services rendered by it fees ranging from \$1,000 to \$1,500,000.